

**LOCAL GOVERNMENT
ENTITIES
AND
HIGHER EDUCATIONAL
INSTITUTIONS
AUDIT AND REPORTING
GUIDANCE**

**SECTION
600**

TABLE OF CONTENTS

<u>TOPIC</u>	<u>SECTION</u>
<i>Audit Reporting Requirements</i>	
General Information	601
Audit Requirement	605
Audited Statements of Claim.....	610
Audit of a Component Unit of an Organization.....	615
Reconciliation.....	620
Program-Specific Audits	625
GASB Statement 34.....	630
GASB Statement 35.....	635
Audit Report Submission.....	640
<i>Audit Testing</i>	
Preliminary Procedures.....	645
1. Determining the Entity Type	
2. Identifying the Client	
Audit Testing Requirements.....	650
Encumbrances and Contingencies	655
CalWORKs Programs.....	660
Maintenance of Effort Requirement	670

LOCAL GOVERNMENT ENTITIES & HIGHER EDUCATIONAL INSTITUTIONS

AUDIT REPORTING REQUIREMENTS

GENERAL INFORMATION

601

The California Department of Education (CDE) disburses public funds to both public and private agencies to provide Child Development Programs (CDPs), Nutrition Programs (NPs) and Adult Basic Education Programs (ABEs). Agencies contracting with a state agency to administer public monies have a responsibility to render a full accounting of their financial activities. Although not always an explicit legislative requirement, such accounting is implied when an agency contracts for public funds. This reporting should identify not only the objectives for which the public resources have been applied but also the manner and effect of their application. Therefore, agencies utilizing public funds must have adequate accounting systems and must arrange for an annual financial audit.

AUDIT REQUIREMENT

605

Section 8200 et seq, Section 8500 et seq, CA Education Code
7CFR225, 7CFR226

Agencies that contract for CDPs, NPs and ABEs must submit an annual audit report. Audits of CDPs, NPs and ABEs administered by local governments and higher educational institutions must be performed by an individual with the qualifications described in **Section 210** of the Guide.

Audits are required in order to verify that agencies maintained accounting and management systems and related internal controls sufficient to ensure that program funds were controlled and expended in compliance with program laws, regulations, and contract provisions during the period examined.

This guidance supplements audit procedures necessary to perform an examination in accordance with generally accepted auditing standards. This is not a complete manual of procedures, nor does it supplant the auditor's judgment. These audit procedures do not cover all circumstances encountered in the audit of agencies, and the auditor must use professional judgment in meeting conditions not covered by the Guide.

The types of audits prescribed and the criteria for each are described in Section 270 of the Guide. Of particular note to local governments and institutions of higher learning:

1. Audited Statements of Claim are no longer sufficient as sole reporting documents for county welfare departments.
2. Audit of a Component Unit of an Organization
3. Reconciliation of Contractor or Component Unit Audits to Entity's Audit Report

LOCAL GOVERNMENT ENTITIES & HIGHER EDUCATIONAL INSTITUTIONS

AUDIT REPORTING REQUIREMENTS

4. Program-Specific Audits
5. Government Accounting Standards Board (GASB) Statement 34 Implementation
6. GASB Statement 35 Issuance

AUDITED STATEMENTS OF CLAIM

610

Audited Statements of Claim are no longer sufficient as the sole reporting documents for county welfare departments. This Guide supersedes the *Audit Guide for Auditors of Child Development Programs Administered by County Welfare Departments*, issued by CDE for fiscal year 1989-90. The Guide now requires the rendering of an auditor's opinion on the financial statements and supplementary information covering the CDPs (and on the Single Audit, if applicable). See **SECTION 605(2) and SECTION 271(4)**.

AUDIT OF A COMPONENT UNIT OF AN ORGANIZATION

615

Definition of a Component Unit: "Component units are legally separate organizations for which the elected officials of the primary government are financially accountable. In addition, component units can be other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete." [GASB 14, ¶12 and ¶20]

As noted in Section 270, the agency (contractor) is required to submit an audit of the financial statements of the entire organization providing child care services, in addition to the audits of individual CDD contracts or programs. This is required when the contractor's CDP funding, NSD or ABE federal funding expended is between \$25,000 and \$300,000.

Contractors may elect to use one audit firm (component unit auditor) to audit the unit that receives, encumbers and spends CDE funds and operates CDE programs, and another firm (entity auditor) for the audit of the entire organization. In this situation, the entity audit will encompass the financial statements and supplementary information for all component units. The component unit auditor will, in addition to auditing the financial statements for the component unit, be responsible for testing and auditing the supplementary schedules and disclosures required by CDE. If the contractor elects to have an audit of the component unit that manages CDE programs, it is still required to submit the audited financial statements and supplementary information of the entire organization. See **SECTION 230** for reporting deadlines. If a component unit audit is performed, only the costs of that audit can be charged to the CDE programs. The costs of the entity audit cannot also be allocated to CDPs.

LOCAL GOVERNMENT ENTITIES & HIGHER EDUCATIONAL INSTITUTIONS

AUDIT REPORTING REQUIREMENTS

If a governmental or not-for-profit agency's CDP, NSD or ABE federal funding exceeds \$300,000, a Single Audit performed in accordance with OMB Circular A-133 is required. Section .500(a) of OMB A-133 also allows for the audit of a component unit of an organization, provided that the component unit audits encompass the financial statements and schedule of expenditures of Federal awards for each such unit. The financial statements and schedule of expenditures of Federal awards must be for the same fiscal year.

See **APPENDIX A3.1** - example audited financial statements and supplementary information for a local government entity's Child Development Fund and component unit.

RECONCILIATION

620

There are certain situations under which an auditee is required to submit a financial statement reconciliation. Local governments and institutions of higher learning typically fall within this requirement. Common examples are when: a) an audit of the component unit operating CDE programs is submitted and the component unit's financial information is not distinct within the entity's audited statements; and b) a contractor audit is submitted, but the organization has a fiscal year end (FYE) other than June 30.

1. As noted in section 615 above, organizations electing to have an audit of the component unit that manages CDE programs are required to submit, in addition to the audited statements of the component unit, the audited financial statements and supplementary information of the entire organization. The supplementary information in the entity audit will generally include a combining statement of the component units within each fund type. If the component unit with CDE programs is shown separately in this schedule, it will not be necessary to prepare a reconciliation. See **Appendix A3.4 through A3.7**– supplementary information from local government entity audit, including example component unit.

If the component unit's financial position and results of operations are not readily discernible from the other component units' in the entity's audited financial statements, the organization is required to submit a reconciliation of the two audited financial statements.

2. Organizations with FYEs other than June 30 that submit contractor's audits are required to include a reconciliation schedule. This schedule should reconcile the financial statements in the contractor's audit to those of the entity's Single Audit, CAFR or Annual Report (see **SECTION 271**, and **Example of Reconciliation of Single Audit, CAFR, and Annual Report to Contractor's Audit, Schedule C**).

LOCAL GOVERNMENT ENTITIES & HIGHER EDUCATIONAL INSTITUTIONS

AUDIT REPORTING REQUIREMENTS

City, county, and other governmental contractors must submit the entity's Single Audit report (if subject to OMB Circular A-133) and the reports on internal controls and on program compliance.

PROGRAM-SPECIFIC AUDITS

625

As noted in **SECTION 270(4)**, program (grant/contract) specific audits are not allowable for CDPs. For NPs and ABEs with only one federal program, the audit guides pertaining to those programs should be followed.

Frequently, the FYE of a program-specific audit (or a direct service contract), and the Single Audit's FYE date are different. The period between the two FYEs, is a "stub period." **SECTIONS 272 and 320, subpart B** of this Guide discuss the treatment of stub periods for CDE programs.

GASB STATEMENT 34

630

(applicable to state and local governments)

Statement 34 – *Basic Financial Statements and Management's Discussion and Analysis – for State and Local Governments*, establishes new financial reporting requirements for governmental entities. Implementation will involve a virtual restructuring of governmental financial reporting. The earliest effective date for GASB 34 begins with reports having a FYE of June 30, 2002 (some governments have up to two years after that date to implement it). However, because of the magnitude of changes that will be required, entities should begin planning for implementation.

GASB 34 is effective in phases based on the government entity's total revenues in the first fiscal year ending after June 15, 1999:

<u>Revenues in 1st FY</u> <u>Ending after 6/15/99</u>	<u>Periods Beginning After</u>
Total annual revenues \geq \$100 million	6/15/01
Total annual revenues \geq \$10 million and $<$ \$100 million	6/15/02
Total annual revenues $<$ \$10 million	6/15/03

Earlier application is encouraged. Future updates of this Guide will include samples of the new reporting model.

LOCAL GOVERNMENT ENTITIES & HIGHER EDUCATIONAL INSTITUTIONS

AUDIT REPORTING REQUIREMENTS

GASB STATEMENT 35

635

(applicable to public colleges and universities)

During 1999, the GASB discontinued development of a separate reporting model for public colleges and universities. These entities will follow the requirements of the new reporting model for state and local governments. GASB Statement 35, *Basic Financial Statements – and Management’s Discussion and Analysis – for Public Colleges and Universities* amends GASB 34, thereby including public colleges and universities in the scope of that standard. (Private colleges and universities will continue to follow FASB guidance).

Implementation dates for public institutions of higher learning will depend on the institutions’ total annual revenues in the first fiscal year ending after June 15, 1999. College and universities that are a component unit of a state or local government will implement the requirements of GASB 35 no later than the same year as their primary government, regardless of the amount of each component unit’s revenues.

AUDIT REPORT SUBMISSION

640

Audit report submission deadlines and instructions are listed in **SECTION 230** of this Guide. The audit, after review and any revision by the Department of Education's Audits and Investigations Division (AID), shall be the final accounting of any amount payable to or receivable from the agency pursuant to the CDP, CNP or ABE contract.

Local governments and institutions of higher learning should be aware that component unit audits are due on the 15th day of the fifth month after the component unit’s year-end. However, the entity’s Single Audit is due to CDE no later than one year after the end of the audit period unless a longer period is agreed to by the cognizant agency.

LOCAL GOVERNMENT ENTITIES & HIGHER EDUCATIONAL INSTITUTIONS

AUDIT TESTING

PRELIMINARY PROCEDURES

645

1. Determining the Entity Type

Certain financial accounting and auditing guidance are only applicable to particular entities. The line between entity types can become blurred when working with governmental and higher educational institutions. Some distinctions are provided in paragraph 1.03 of the AICPA Audit and Accounting Guide *Not-for-Profit Organizations* (with conforming changes as of May 1, 1999):

“Public corporations and bodies corporate and politic are governmental organizations. Other organizations are governmental organizations if they have one or more of the following characteristics:

- a. Popular election of officers or appointment (or approval) of a controlling majority of the members of the organization’s governing body by officials of one or more state or local governments;
- b. The potential for unilateral dissolution by a government with the net assets reverting to a government; or
- c. The power to enact and enforce a tax levy.

Furthermore, organizations are presumed to be governmental if they have the ability to issue directly (rather than through a state or municipal authority) debt that pays interest exempt from federal taxation. However, organizations possessing only that ability (to issue tax-exempt debt) and none of the other governmental characteristics may rebut the presumption that they are governmental if their determination is supported by compelling, relevant evidence.”

It is important to determine the type of entity that will be audited before your engagement begins, so that the proper audit and reporting guidance is followed.

2. Identifying the Client

The governing boards in local governments and institutions of higher learning will likely be much further removed from the daily operations of the CDPs, NPs and ABEs than their counterparts in other not-for-profit or nongovernmental agencies. This distance aside, the board of supervisors (or city council or board of trustees) is the management body to whom reports and issues will be addressed.

LOCAL GOVERNMENT ENTITIES & HIGHER EDUCATIONAL INSTITUTIONS

AUDIT TESTING

AUDIT TESTING REQUIREMENTS

650

California Education Code section 8200 et seq.

California Code of Regulations, Title 5, section 18000 et seq.

Audits of CDPs, NPs and ABEs must be performed in accordance with generally accepted auditing standards, the standards applicable to the type of entity and award, and the instructions contained in this Guide. Although the financial reporting requirements for local government entities and higher educational institutions differ from those of other contractors, the general and specific audit requirements for the programs are similar. Auditors of government entities and educational institutions should refer to **SECTIONS 300, 400 and 700**: Single Audit Requirements; CDP and ABE Program General and Specific Audit Requirements; and Nutrition Programs Audit Reporting, respectively) for the audit testing particular to the entities' awards. Auditing issues specific to local government entities and higher educational institutions are discussed below.

ENCUMBRANCES AND CONTINGENCIES

655

The testing of expenses should include a review of encumbrances and contingencies. Although these adjustments represent proper accounting treatment for government entities and higher educational institutions, they cannot be charged as expenses to CDPs, NPs and ABEs. **SECTION 430** of the Guide describes audit procedures to determine whether encumbrances or contingencies have been charged to expenses.

CALWORKS PROGRAMS

660

The CalWORKs programs have unique characteristics and requirements. **SECTION 422** of the Guide describes audit objectives and verification procedures for auditors of these contracts.

LOCAL GOVERNMENT ENTITIES & HIGHER EDUCATIONAL INSTITUTIONS

AUDIT TESTING

MAINTENANCE OF EFFORT REQUIREMENT

670

(applicable to County Welfare Departments only)

CA Education Code, 1998 ed.

I. OBJECTIVE

The allocation of state funds for child care services within a county are subject to the Maintenance of Effort requirements of Education Code sections 8279 and 8279.1:

8279. Each county shall, as a minimum, maintain the level of expenditure for child development services provided by the county during the 1970-71 fiscal year. These funds shall be used exclusively for child development programs and shall be considered unrestricted funds unless restricted by the county granting the funds.

8279.1. (a) The Legislature recognizes that child care programs have made valuable contributions towards ensuring that public assistance recipients will be able to accept and maintain employment or employment-related training. Therefore, it is the intent of the Legislature that the State Superintendent of Public Instruction ensure that counties comply with the requirements of section 8279.

(b) The State Superintendent of Public Instruction shall ensure each county's compliance with section 8279 by doing all of the following:

The State Superintendent of Public Instruction shall not issue funds to a local child care contractor within a county until the Superintendent of Public Instruction has received written certification from that county that the level of expenditure for child care services provided by the county has been maintained at the 1970-71 fiscal year level pursuant to section 8279. Funding provided by a county to a local child care contractor shall not adversely affect the reimbursement received by the agency from the State Superintendent of Public Instruction pursuant to Section 8265, 8265.5, 8266, or 8266.5.

II. GENERAL AUDIT PROCEDURES

Verify that the county has maintained child development service expenditures at a level at least equal to that of the 1970-71 fiscal year.

See **SECTION 491, Special Audit Instructions**, for discussion regarding the two distinct types of MOE contracts.